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Nos. 190 and 268

In the Supreme Court of the United States

October Term, 1961

United States, petitioner

v.

Thomas Crawley Davis, et al.

Thomas Crawley Davis, et al., petitioners

v.

United States

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

[illegible]

Department of Justice, Washington 25, D.C.

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OPINION BELOW

The opinion of the Court of Claims (R. 100–123) is reported at 287 F. 2d 168.

JURISDICTION

The judgment was entered on March 1, 1961. (R. 123.) By order of the Chief Justice, dated May 23,

1961, the time for filing a petition for a writ of certiorari in No. 190 was extended to and including June 29, 1961. (R. 124.) On June 1, 1961, the Chief Justice extended the time for filing a petition for a writ of certiorari in No. 268 to and including July 29, 1961. (R. 125.) The petition for writ of certiorari in No. 190 was filed on June 29, 1961, and the petition for writ of certiorari in No. 268 was filed on July 28, 1961. This Court granted the petitions on October 9, 1961, and ordered the cases to be consolidated. The jurisdiction of this Court rests on 28 U.S.C. Section 1255.

QUESTIONS PRESENTED

1. Whether a husband realizes taxable gain when he transfers to his divorced wife, in return for the release of her marital claims, assets which have appreciated in value during his ownership (No. 190).

2. Whether legal fees paid by a husband to his wife's attorney for advice given to her about the tax consequences of a proposed property settlement agreement are deductible by him under § 212(3) of the Internal Revenue Code of 1954 as "ordinary and necessary expenses paid or incurred * * * in connection with the determination, collection, or refund of any tax" (No. 268).

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are §§ 61(a), 212(3), 1001, and 1002 of the Internal Revenue Code of 1954; §§ 12–901 and 13–1531 of the Delaware Code Annotated; and §§ 1.212–1, 1.1001–1, and 1.1002–1 of the Treasury Regulations on Income Tax (1954

Code). These are set forth in the Appendix, *infra*, pp. 51–56.

STATEMENT

The material facts, as found by the Court of Claims (R. 111–123), may be summarized as follows:

ISSUE 1 (NO. 190)

On November 4, 1954, Thomas Crawley Davis ("the taxpayer") and his former wife, Alice M. Davis,[1] executed a formal property settlement and separation agreement. The agreement was negotiated by lawyers for the two principals after extended bargaining. (R. 115–117.) The agreement recited that (R. 117)—

> the parties hereto intend by this agreement to settle their respective rights and obligations against and to one another by (1) making a division of their property; (2) providing in lieu of alimony in the event of a decree of divorce for the support and maintenance of the wife; (3) making an arrangement and provision for the support and maintenance of Stephen; and (4) defining the rights of custody, maintenance, support and education of their minor child.

All of the property involved in the settlement negotiations was owned by Mr. Davis subject only to the marital rights of Mrs. Davis under Delaware law. (R. 115.)

As a "division in settlement of their property" the taxpayer agreed, *inter alia,* to transfer to Alice M.

[1] Respondent Grace Ethel Davis is taxpayer's present wife. She is a party to this proceeding only because she and her husband filed a joint tax return in 1955.

Davis 1,000 shares of duPont stock, 500 shares to be delivered by April 1, 1955, and 500 shares by April 1, 1956. (R. 117.) Mrs. Davis, on her part, agreed to accept (R. 117–118)—

> the division of property herein provided in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy), which she ever had, now has, or might ever have against the husband by reason of their relationship as husband and wife or otherwise.

The parties further agreed (R. 97)—

> The parties hereto and each of them covenant that this agreement is and shall be a complete and final settlement of all claims of every nature and kind between them. Upon performance of husband's covenants and undertakings under this agreement, the wife hereby waives, releases and relinquishes unto the husband all rights that she might otherwise have to any of the property of the husband and to any claim for support or maintenance for herself and their minor child * * *.

The agreement provided that in the event a decree of divorce should be granted "such decree shall in no way effect the obligations of either of the parties hereunder" and that the provisions of the agreement might, but need not, be incorporated into such decree, subject to the approval of the court granting such divorce. (R. 98, 118.) Other provisions of the agreement, not material here, provided for the disposition of other properties (house, automobile, and insurance

policies), periodic payments to the wife "for her maintenance and support," and the creation of a trust for the support of the child. (R. 117–118.)

On January 5, 1955, Alice M. Davis was granted a final decree of divorce from Mr. Davis by the Second Judicial District Court of the State of Nevada. The court's decree approved the settlement agreement of the parties and directed them to carry it out. (R. 111.)

On March 21, 1955, taxpayer, pursuant to the agreement, transferred to Mrs. Davis 500 shares of du Pont common stock. His cost basis in these shares was \$74,775.37 and their fair market value at the time of the transfer was \$82,250. (R. 121, 122.) The Commissioner determined an income tax deficiency for 1955 on the ground that Mr. Davis realized a taxable gain of \$7,474.63, the difference between the two figures. (R. 100.) Overruling the Commissioner's determination, the Court of Claims held that (R. 109–110), although the taxpayer may have realized economic gain, he did not realize taxable gain under the provisions of § 1001(a) of the 1954 Code. The Court reasoned that (R. 109) the statutory definition of "amount realized" calls for a determination of "fair market value of the property * * * *received*" and that there were no adequate criteria for measuring the value of the marital rights released by Alice M. Davis.

ISSUE 2 (NO. 268)

Shortly prior to June 15, 1954, about five and one-half months before the execution of the separation and property settlement agreement, taxpayer's wife, Alice M. Davis, consulted an attorney, James R. Morford,

with respect to her marital difficulties and obtaining a property settlement. Taxpayer, that summer, retained H. Albert Young as counsel to represent him in the matter. These attorneys negotiated the separation and property settlement but did not act for their clients in connection with the divorce suit in Nevada, which was independently handled by a Nevada law firm. (R. 115, 119.)

Throughout the subsequent negotiations in relation to the separation and property settlement agreement, both Mr. Young and Mr. Morford considered the Federal income and gift tax consequences flowing from the various phases of the proposals made during the course of negotiations. Each attorney, however, considered such problems from the standpoint of his own client. (R. 119.)

During the negotiations, Mr. Morford and Mr. Young advised taxpayer that it was the practice, in conformity with Delaware law, that the husband pay the attorneys' fees of both parties in connection with negotiations for a separation and property settlement agreement. As a result, although this agreement was not incorporated in the separation and property settlement agreement, taxpayer paid his wife's attorney (Mr. Morford) fees totalling $10,000 in addition to his own attorneys' fees totalling $12,506. (R. 120.)

In each instance the fee was based on two separate bills received by taxpayer from the respective attorney. One was for services relative to the separation agreement and property division, for which Mr. Young charged $7,506 and Mr. Morford $5,000. The other bill, as rendered by Mr. Young, was for services

"Re: Tax matters in the case of Davis v. Davis" and, as rendered by Mr. Morford, "To professional services rendered in connection with tax matters involved in the matter of Alice M. Davis versus T. Crawley Davis". For these services Mr. Young charged $5,000 and Mr. Morford $5,000. Taxpayer made partial payments on the various bills in 1954 and paid the remainder in early 1955, $5,000 of which was on the bills for tax advice ($2,500 as to each attorney). (R. 120.)

Mr. Morford testified that he allocated his total fee into the two categories, the property settlement and tax advice, at the request of the taxpayer and that he could not possibly segregate his fee in such a manner and justify the amount of one bill as against the other. However, he testified that tax problems "underlaid the whole relationship of the parties" and that he believed that the allocation of the fee, as carried out at the request of taxpayer, appeared to be entirely reasonable.[2] (R. 120–121.)

In his 1955 tax return, taxpayer claimed a deduction for legal fees in the amount of $5,000, composed of the $2,500 payments made to each attorney for tax advice in connection with the separation and property settlement agreement. The Commissioner disallowed the claimed deduction and taxpayer subsequently paid

[2] As to Mr. Young, taxpayer's attorney, the court below noted (R. 121) that "in his appearance as a witness in this case, Mr. Young's testimony was vague and general as to the reasonableness and propriety of the division of his overall fee into the two categories, and he did not state whether the segregation was made by him independently or at the suggestion of Mr. Davis."

the resulting deficiency and filed a proper claim for refund. (R. 121, 122.) This suit for refund followed.[3]

The Court of Claims held that taxpayer was entitled to deduct the attorneys' fees he paid to his own attorney, Mr. Young, for his services in regard to tax matters but that he was not entitled to deduct the fees he paid to his wife's attorney, Mr. Morford, for the same type of service to the wife. (R. 103–104.)

SUMMARY OF ARGUMENT

I

A. The first question in this case is whether the taxpayer-husband realized a taxable gain upon the transfer to his wife, pursuant to a divorce settlement, of appreciated property in exchange for a release of her marital rights. The gain upon such a transfer has been held to be taxable by the Third and Second Circuits, in the *Mesta* and *Halliwell* cases, and to be nontaxable by the Sixth Circuit, in the *Marshman* case. In this case, the Court of Claims, following the *Marshman* case and rejecting the *Mesta* and *Halliwell* decisions, held that the gain was not taxable.

The resolution of that issue turns upon two distinct questions. The first is whether a property settlement

[3] In his claim for refund taxpayer also claimed a deduction for the remainder of the attorneys' fees paid to the two attorneys in 1955, which were for services in negotiating the separation and property settlement agreement. (R. 122.) This issue is not before this Court, since the Court of Claims denied the deduction and taxpayer did not petition on that issue. A similar issue is, however, before this Court in two other pending cases, *United States* v. *Gilmore* (No. 255, October Term, 1961), and *United States* v. *Patrick* (No. 256, October Term, 1961).

incident to a divorce should be treated as a taxable event at all—*i.e.,* whether it is the kind of "sale or other disposition of property" in which an accounting for gain or loss is required. The second is whether, assuming that it is a taxable event, the gain can be measured by the value of the property transferred, presuming that value to be equal to the value of the wife's rights given up in exchange. Like the Sixth Circuit in the *Marshman* case, the Court of Claims in this case seems not to have questioned that the transaction was in kind a taxable event, basing its decision, rather, solely on the ground that there was no way to measure the gain. In our view, however, the crucial question in the case is the initial one whether the transaction should be treated as a taxable event and it is with that question that we will first deal.

B. Marital property settlements being *sui generis,* their characterization for tax purposes poses an admittedly perplexing question. There are, however, two alternative categories of transactions to which they might be likened, and the choice between them is, we believe, the question upon which the decision in this case should turn.

The first category, in which we contend the transaction here should be placed, consists of transfers in discharge of an indebtedness. Transfers of property to satisfy a liquidated money obligation are admittedly deemed to be taxable exchanges, and the fact that the claim discharged has not previously been reduced to a liquidated dollar amount is plainly not in itself a difference in kind (though it might raise the measurement question discussed

below). A transfer of property in satisfaction of a tort claim for personal injuries, for example, would clearly be a taxable event. It cannot be denied, however, that there are differences, in shading at least if not in nature, between obligations of that sort and those of the wife discharged by the property settlement here. A tort obligation, for example, arises and is measured independently of what is owned by, and represents merely a "creditor's" claim against, the tortfeasor. Under Delaware law, however, the wife's rights upon divorce are defined primarily by a statute directing the divorce court to award to her "such share" of the husband's estate as the court deems "reasonable." There is, therefore, at least the difference that her rights are measured, not independently, but by what the husband has. Yet that measurement of what the wife is entitled to receive hardly converts what is otherwise but a personal liability of the husband for maintenance and support into a "property" or "equity" interest in the husband's property itself. Thus, while recognizing that there are differences between a wife's marital rights and other "independent" obligations, we do not believe the differences are sufficient to justify excepting transfers of property in discharge of such rights from the general principle that a transfer of property for a release of a legal obligation is to be treated as a taxable "exchange." That is the characterization of transfers in discharge of marital rights that has been uniformly followed by the lower courts, and it is, we submit, the sounder view of such transactions.

The analogy to which petitioner contends divorce settlements should be likened is that of a "division" of property among persons having a pre-existing right to "share" in it. Examples of transactions which are deemed to be nontaxable "divisions" rather than taxable "exchanges" include divisions in kind of jointly-owned or community property, of partnership assets among the partners, and of the assets of a trust or estate among those beneficially entitled to a "share" of the corpus (as distinguished, *e.g.*, from a legatee entitled to a fixed dollar amount). In all of those cases, however, the recipient has a recognized "property" interest in the assets being divided, which a wife in a common-law state plainly does not have. The fact that the allowance to a divorced wife, under the Delaware statute, is measured by "such share" of the husband's property as the court deems "reasonable" does, we acknowledge, give to a property settlement satisfying that right something of the flavor of a "division" of property. To that extent, and since state concepts of "property" are not necessarily controlling for tax purposes, it might not have been unreasonable as an original matter to have likened marital settlements, notwithstanding the conceptual differences, to a "division" of property. Yet property concepts are important for tax purposes, and we do not believe that the "division" cases should be extended beyond transactions involving recognized "property" interests. At the very least, the consistent rejection by the lower courts, over a period of twenty years, of that characterization of marital settlements in favor of treating them as taxable "ex-

changes" of property for a release of legal obligations is a permissible resolution of the question and ought not now be upset.

C. Respondent alternatively contended in the court below that property settlements should be treated as "gifts", on the premise that marital obligations, voluntarily assumed in a transaction (the marriage) springing out of purely personal motivations, ought not be given any greater significance as "consideration" for income tax purposes than they have traditionally been given for gift and estate tax purposes. Whatever might have been said for that characterization were it an open question, that treatment of such transfers is, we believe, foreclosed by this Court's decision in *Harris* v. *Commissioner,* 340 U.S. 106.

D. Assuming that property settlements incident to a divorce are to be treated as taxable "exchanges" of property in satisfaction of legal obligations, there remains the question of measurement of the gain. It was on that ground that the Court of Claims' decision was based, the court holding that, while there was a taxable "exchange", there was no way to measure the value of what was "received" and thus no way to compute the gain. There is, however, more than ample authority for measuring what is received in an exchange, in the absence of other evidence, by the value of what is given. That amounts simply to a presumption that the values of properties exchanged in an arm's-length transaction are equal—a presumption generally in accord with common experience and in any event justified by

necessity. Having concluded that the transaction is of the kind that Congress intended to tax, it is surely preferable to adopt a measure of the gain at least approximat~~ely~~ng the result intended rather than to defeat the purpose altogether.

In our view, the inability-to-measure ground of the Court of Claims' decision, which among other things will produce an inconsistent basis consequence to the wife, is not a permissible solution to the problem presented by marital settlements. They should either be held not to be taxable "exchanges" at all—*e.g.*, on the "division" of property analogy, which we concede to be at least a permissible characterization—or, if held to be taxable, the best measure of the gain available should be adopted. The deficiencies, if any, in the tools for measurement of the gain are at most considerations to be taken into account in deciding whether to treat such transfers as taxable events. They should not lead to the anomaly—and anomalous consequences—of treating the transaction as taxable in theory but not in practice.

II

The court below properly denied the taxpayer a deduction for his payment of attorneys' fees incurred by his wife for advice as to the tax consequences of the various proposals made in connection with the separation and property settlement agreement. The deduction provision relied upon by taxpayer does not permit the deduction of legal fees for such tax advice and, even if it did, taxpayer would not be entitled to a deduction for his wife's expenses.

Section 212(3) of the Internal Revenue Code of 1954, under which the deduction is claimed, allows a deduction only for the ordinary and necessary expenses paid "in connection with the determination, collection, or refund of any tax." This language and the legislative history of the provision show clearly that Congress intended to allow a deduction for tax advice only in connection with the computation or contesting of accrued tax liability.

Even if § 212(3) were construed so broadly as to allow a deduction for expenses incurred for advice on the tax aspects of prospective transactions, taxpayer would not be entitled to the claimed deduction for the fees paid his wife's attorney. As the court below explained, the fees were incurred by the wife for tax advice as to her own tax problems, not taxpayer's. Accordingly, the wife's fees were not, as to taxpayer, an expense paid for tax advice. Their payment by him was merely a part of his settlement with his wife, made by him because under Delaware practice it is customary for the husband to pay the attorneys' fees which the wife incurs in connection with a separation and property settlement agreement.

ARGUMENT

I

THE TAXPAYER'S TRANSFER OF APPRECIATED PROPERTY TO HIS WIFE IN EXCHANGE FOR A RELEASE OF HER MARITAL CLAIMS RESULTED IN A REALIZATION OF TAXABLE GAIN

A. INTRODUCTION

1. Pursuant to a property settlement agreement, the taxpayer transferred to his wife [4] shares of stock that had appreciated in value over the taxpayer's cost basis for them. In exchange the wife, by the agreement, accepted the stock in full satisfaction of all of her rights against the taxpayer arising out of the marriage. The question is whether the husband, by the use of his appreciated stock to satisfy his legal obligations to his wife, realized a taxable gain on the transaction equal to the excess of the value of the stock over his basis.

A collateral question, not directly involved in this case but important to a consideration of the problem it poses, is the basis the stock will have in the hands of the wife. If the husband is taxed on the gain, then the wife should receive a basis for the property equal to its fair market value so that, if she subsequently disposes of the property, she will not be taxed on the same gain. Contrariwise, if the husband is not taxed on the gain, the wife should take the stock with the same basis it had in the husband's hands so that the gain does not escape taxation entirely. By

[4] "Husband" and "wife" are used in this brief to include divorced spouses.

and large, the two consequences are corollaries, and the incident found determinative of the recognition of gain by the husband will also control the wife's basis. Thus the effect on the wife's basis is an important consideration in determining how the transaction should be treated for purposes of the husband's recognition of gain.

The Tax Court originally held that a husband did not realize taxable gain upon a transfer of appreciated property to his wife in discharge of marital obligations. However, the Third Circuit in 1941, followed by the Second Circuit in 1942, held that the husband did have taxable gain. *Commissioner* v. *Mesta,* 123 F. 2d 986 (C.A. 3), reversing 42 B.T.A. 933, certiorari denied, 316 U.S. 695; *Commissioner* v. *Halliwell,* 131 F. 2d 642 (C.A. 2), reversing 44 B.T.A. 740, certiorari denied, 319 U.S. 741. The Tax Court in due course accepted those decisions, applying them to give the wife a "cost" basis for property received in a property settlement equal to the fair market value of the property. *Hall* v. *Commissioner,* 9 T.C. 53.[5] The Second and Fourth Circuits have applied substantially the same principles to give a wife a fair market value basis for property received by her in

[5] In that case, the parties to the agreement had themselves placed a dollar valuation on the property that the wife was to receive, and the Tax Court used that valuation as the parties' measure of the value of the wife's rights, without determining whether the true fair market value of the property transferred differed from their valuation. That distinction is not important here, where the parties did not put a valuation on the property. See *Marshman* v. *Commissioner*, 31 T.C. 269, reversed, 279 F. 2d 27 (C.A. 6).

exchange for a release of marital rights by an antenuptial agreement (*Farid-Es-Sultaneh* v. *Commissioner,* 160 F. 2d 812 (C.A. 2)) or by an agreement made during coverture (*Commissioner* v. *Patino,* 186 F. 2d 962 (C.A. 4)).

The Sixth Circuit, however, rejected the *Mesta* and *Halliwell* decisions and held that a transfer of appreciated property to a wife pursuant to a divorce settlement resulted neither in a taxable gain to the husband nor, consistently, a fair market value basis in the wife. *Commissioner* v. *Marshman* (consolidated with *Estate of Stouffer* v. *Commissioner*), 279 F. 2d 27 (C.A. 6), certiorari denied, 364 U.S. 918. In this case, the Court of Claims has now sided with the Sixth Circuit in holding that the husband realizes no taxable gain in such a transaction. It was to resolve that conflict that the case was brought here.

2. The statutory framework of the question is simple. Section 61(a) of the Internal Revenue Code of 1954 [6] defines gross income as meaning "all income from whatever source derived, including (but not limited to) * * * (3) Gains derived from dealings in property." Section 1001 provides that:

> (a) The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis * * *.
>
> (b) The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value

[6] Unless otherwise indicated, all section references in this brief are to the 1954 Code.

of the property (other than money) received.
* * *

Applying the settled principle that the satisfaction of a legal obligation (*e.g.*, the discharge of a debt) is a receipt to the obligor, the courts in the *Mesta* and *Halliwell* cases held that the release or discharge of the husband's legal obligations to his wife, in exchange for his transfer of property to her, was a sufficient "receipt" to make the transaction a taxable exchange under those provisions. Acknowledging the difficulty of independently valuing the marital claims released by the wife, those courts held further that the value could properly be measured by the value of the property transferred by the husband to the wife, that being presumably the value the parties put upon the wife's rights in agreeing to the settlement.

The Sixth Circuit in *Marshman* and the Court of Claims in this case did not disagree that the transaction was in nature a taxable event—*i.e.*, a "sale or other disposition" of property in exchange for a receipt of a discharge of a legal obligation. They held, however, that because of the variety of the factors influencing a divorce settlement negotiation, the value of the rights released by the wife could not properly be measured by the value of the property given by the husband, and accepted by her, in satisfaction of them. There being no other way to value those rights, there was, the courts held, no way to determine the "amount realized" by the husband and hence no way to compute the amount of his gain. In short, those courts, while seemingly agreeing that such a transaction produces a gain of the kind meant to be taxed by the statute, relieve the hus-

band from tax on that gain only because of an inability to measure its amount.

The stated ground for the decision below is not, we will show, supportable. If a transfer of appreciated property in satisfaction of marital rights is otherwise properly to be treated as a taxable event, there can be no doubt, we think, of the propriety of measuring the value of the receipt, in the absence of any other measure, by the value of the property transferred. We acknowledge, however, that the decision below, although rationalized in terms of the inability to value the receipt, may reflect an underlying conviction that a marital property settlement ought not be treated as a taxable event at all. Accordingly, before turning in the measurement-of-value question, we will deal explicitly with the question whether a transfer of property in satisfaction of marital rights is properly to be treated as a taxable exchange giving rise to a realization of gain or loss.

B. A PROPERTY SETTLEMENT SHOULD BE DEEMED A TAXABLE EVENT IN THE NATURE OF A TRANSFER OF PROPERTY IN DISCHARGE OF A DEBT RATHER THAN A NONTAXABLE "DIVISION" OF PROPERTY

As *Helvering* v. *Horst,* 311 U.S. 112, teaches, questions of realization cannot be solved by a mere parsing of the statutory language or by logical imperatives. Starting with the evident purpose of Congress, by its sweeping definition of income, to reach all "gains" or accessions to wealth (see *Commissioner* v. *Glenshaw Glass Co.,* 348 U.S. 426), the problem becomes the pragmatic one of determining what constitutes an appropriate occasion for the reckoning up by the taxpayer of the economic gains that have accrued to him. Ad-

ditionally, since marital rights and obligations are unique in their nature, the problems posed by transfers in satisfaction of them must be acknowledged to be *sui generis*. Accordingly, while on balance we believe that such a transfer provides an appropriate occasion for accounting for the husband's gain or loss on property held by him and transferred to his wife, and should be treated as a taxable event, we do not offer that conclusion as a matter of logical compulsion or as the dictate of immutable principles governing the question of realization in other areas.

There are perhaps three ways of characterizing marital settlements for tax purposes: (1) as a transfer of property in "exchange" for the release of a legal obligation; (2) as what may be called a "division of property," simply giving to the wife that "share" of the husband's estate to which she is equitably entitled; or (3) as a "gift." The government contends for the first; the respondent, primarily for the second but alternatively for the third. We shall consider here the choice between the first two alternatives, the choice primarily in dispute, and then show in the next point why we think such a transfer cannot be treated as a gift.

1. It is axiomatic, of course, that a transfer of property in satisfaction of an independent legal obligation is a taxable event upon which gain or loss is to be recognized. Thus, the use by an estate or testamentary trust of appreciated property to satisfy legacies of fixed dollar amounts (enforceable as a debt) is treated as a sale or exchange on which the estate or

trust must recognize the gain.[7] Nor is that result dependent upon the obligation being for a liquidated dollar amount; there can be no doubt, for example, that a transfer of property in settlement of a tort suit for personal injuries would be a taxable sale or exchange of the property.

On the other hand, if the transferee has a pre-existing property right to a "share" of the property itself, the partition or division of the property, and the distribution to the transferee of his share, is not generally a taxable event. That is true, for example, of the partition in kind of jointly-owned property,[8] of the division of partnership property among the partners upon dissolution,[9] or of the division of the corpus of an estate or trust and the distribution of their respective shares to legatees or trust beneficiaries.[10] That may also be the explanation in part for not treating distributions in kind by a corporation to its stockholders as a taxable event to the corporation.[11]

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[7] *Suisman* v. *Eaton*, 15 F. Supp. 113 (D. Conn.), affirmed *per curiam*, 83 F. 2d 1019 (C.A. 2), certiorari denied, 299 U.S. 573; *Kenan* v. *Commissioner*, 114 F. 2d 217 (C.A. 2). See also *Gransden & Co.* v. *Commissioner*, 117 F. 2d 80 (C.A. 6); *Warren* v. *Commissioner*, 117 F. 2d 82 (C.A. 6). For the general principle that release of an indebtedness is a receipt by the obligor, see, *e.g.*, *Commissioner* v. *Jacobson*, 336 U.S. 28.

[8] Rev. Rul. 55–77, 1955–1 Cum. Bull. 339; Rev. Rul. 55–179, 1955–1 Cum. Bull. 340; Rev. Rul. 56–437, 1956–2 Cum. Bull. 507.

[9] *Crawford* v. *Commissioner*, 39 B.T.A. 521; I.T. 2010, III–1 Cum. Bull. 46; Sol. Op. 42, 3 Cum. Bull. 61.

[10] U.S. Treas. Regs. on 1954 Code, § 1.661(a)–2(f)(1); Rev. Rul. 55–117, 1955–1 Cum. Bull. 233; O.D. 667, 3 Cum. Bull. 52; *Long* v. *Commissioner*, 35 B.T.A. 95.

[11] *General Utilities Co.* v. *Helvering*, 296 U.S. 200.

More closely in point is the division of community property between a husband and wife upon divorce, which is not deemed a sale or exchange.[12]

The property settlement here, and it seems likely in most common-law states, falls somewhere between those two polar situations. In addition to her right to support and maintenance, an undivorced wife's rights under Delaware law include dower, which she may elect in lieu of her rights under a will, and rights of intestate succession (with children surviving, one-third of the personalty and a life estate in one-half of the realty).[13] Her rights upon divorce are governed by the following provision (8 Del. Code Ann., Title 13, § 1531):

> § 1531. *Allowance or division of property upon divorce granted for aggression.* (a) When a divorce shall be decreed for the aggression of the husband, the complainant shall be * * * allowed, out of her husband's real and personal estate, such share as the court thinks reasonable * * *.
>
> (b) Any allowance or division of property under subsection (a) of this section, may be by a gross sum, or an annual allowance, or an assignment by metes and bounds. * * *

With the possible exception of the dower rights in real estate, those inchoate rights plainly do not amount to a vested property interest in the property owned by the husband and, in traditional concepts, are quite

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[12] *Swanson* v. *Wiseman* (W.D. Okla.), decided February 23, 1961 (61-1 U.S. T.C. ¶ 9264); *Walz* v. *Commissioner*, 32 B.T.A. 718.

[13] 8 Del. Code Ann., Title 12, §§ 502, 512, 901, 904, 905.

different from the "property" interests of a partner, of a trust beneficiary, or of a wife in a community-property state. On the other hand, the wife's inchoate right upon divorce to such "share" of the husband's property as the court deems "reasonable" is a claim significantly different in nature from a debt in a specific dollar amount or an unliquidated but independent liability (*e.g.,* a tort claim for personal injuries). If nothing else, it is different at least in that the wife's right is measured, not independently, but by the size of the husband's estate—with the consequence that an increase in the husband's estate through appreciation also operates to increase the amount to which the wife is entitled. And viewing the wife's rights as an inchoate right to a "fair share" of the husband's estate—not as definite in fractional terms as it is in community property states but still a recognition of the wife's right to "participate," as it were, in the husband's gains—it is not implausible to conclude that a property settlement should be analogized, despite the conceptual differences as a matter of property law, to a "division" of property rather than to a transfer in "exchange" for a release of independent personal obligations.

Since marital property settlements do not fit neatly into the mold either of an "exchange" of property in satisfaction of independent liabilities or of a "division" of property, the inevitability of one characterization or the other cannot be dogmatically asserted. Nevertheless, in our view such a transaction is more properly to be viewed as an "exchange" in

discharge of a liability. The very premise of the "division" notion is the recognition of pre-existing "property" rights, and the fact that Delaware, and probably most common-law states, deems it proper to measure the award to the wife by the size of the husband's estate seems hardly enough to convert what is otherwise but a personal liability of the husband to support his wife into a "property" interest of the wife in the husband's property. What the wife receives in a property settlement is not simply a divided part of a whole in which she had previously had an undivided interest, but rather ownership of specific property in lieu of the husband's personal liabilities to her, a conversion of the nature of her rights that can be forced into the mold of a "division" only with considerable straining. On the other hand, the differences between the husband's marital obligations and other legal liabilities, while real, is more a difference of degree than of kind. The measurement of the wife's rights by what the husband has seems ultimately little more than the use of an ability-to-pay standard to fix the amount of the husband's liability to the wife, and the satisfaction of that liability by a transfer of the husband's separate property seems not essentially different from the satisfaction of other kinds of liabilities. And, while the mere partition of, say, a tenancy-in-common may not effect a sufficient change in the nature of ownership to be a taxable event, a marital property settlement clearly does effect a quite complete conversion in the nature of the rights and liabilities of the parties, making it a fully appropriate occasion for a reckoning up of the

previously-accrued gain or loss. Accordingly, a marital property settlement should, we believe, be treated as a taxable "exchange" of property for a release of legal obligations rather than, as respondent contends, a nontaxable "division" of property.

2. We recognize, however, that an exercise in conceptual pigeonholing cannot provide the final answer to what is, after all, a very practical problem of taxation. We turn, accordingly, to a consideration of the practical implications of the choice to be made between the "exchange" and "division" characterizations of marital property settlements.

In seeking the proper tax treatment of property settlements, certainly the most important single desideratum is that the basis of the property in the wife's hands be consistent with the tax treatment of the husband, so that the appreciation will neither escape taxation altogether nor be taxed more than once. For that purpose, however, either of the solutions seems equally acceptable. If the settlement is treated as a taxable exchange of the husband's property for the wife's rights, what the husband is deemed to receive for the property is necessarily the same as what the wife is deemed to "pay" for it. Thus the wife will receive a "cost" basis for the property equal to the value at which the husband was required to account for the gain, and the appreciation will be taxed but once. If the settlement is deemed a nontaxable "division" of property, the wife will have no independent "cost" basis for the property she receives, but the very concept of a division requires that she take the property with the same basis it had in the husband's

hands. Thus the appreciation, though not then taxed, will be taxed if and when the wife disposes of the property, and no income will escape taxation.

So long as a consistent basis treatment is assured, the effect of the choice on the revenues is problematical. Theoretically, taxing the husband would produce the greater revenue, since he is likely to be in the higher bracket and the wife may never make a taxable disposition of the property.[14] On the other hand, the choice of the properties to be transferred to the wife is fully within the control of the parties, and if a tax is to be imposed, they may be expected to select those with the least appreciation, or possibly depreciated properties on which the husband could claim a loss. Additionally, there is some likelihood, for a variety of reasons, that collection of the tax will be less certain if the property settlement, rather than the wife's ultimate disposition of the property, is deemed the taxable event.[15] On bal-

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[14] If she retains the property until her death, for example, her heirs will acquire a new basis for the property equal to its fair market value at the date of her death (§ 1014(a)), and any appreciation up to that date will not be taxed.

[15] For one thing, the valuation problems are often formidable. Although the husband's gain and the wife's basis would theoretically both be measured by the same incident (the value of the property transferred), in ca s of doubtful valuations the husband could be expected to claim a low valuation on his return and the wife, perhaps many years later when she disposes of the property, a high valuation. To assure taxing the full gain would thus often require litigation of the question of value—with consistent findings—with both the husband and the wife, a hope that in practice is not likely to be realized. If, on the other hand, the wife takes the property with the husband's cost basis, the valuation problem is avoided and the full gain is more likely automatically to be reported upon the wife's later sale of the property. While the valuation problem is not peculiar to this area, it does somewhat mute

ance, the substantial likelihood that the gain would otherwise escape taxation entirely through the wife's holding the property until her death suggests that the revenues would be favored by taxing the husband upon the settlement, but we do not suggest that by itself that should be given controlling weight.

Another relevant consideration is the effect of the rule adopted upon the conduct of divorce negotiations—in which the tax consequences are of course an important factor—and the "equities" as between the husband and the wife. If the settlement is not treated as a taxable exchange, and the wife takes appreciated property with the husband's basis and later makes a taxable disposition of it, the effect is to shift the incidence of the tax from the husband to the wife, a result that may seem inequitable. On the other hand, taxing the husband upon the transfer will diminish the total property available for division, and the tax incidence can always be allowed for by adjusting the gross amount of the settlement. Here again, it would seem more important that the rule be certain so that the tax consequences may be taken into account in the negotiations than that one rule or the other be adopted.

3. With the other considerations being inconclusive, we come to the factor that, in our view, should be determinative in favor of treating the transfer as a

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the revenue implications of the decision here. In addition, taxpayers not well advised by tax counsel are perhaps likely to be less attuned to the tax consequences of a divorce settlement than to those of the wife's later sale of the property, with the consequence that a failure to report divorce-settlement "exchanges" may occur with a higher incidence than a failure to report the wife's sale.

taxable exchange, and that is the force of precedent. While, as an original matter, the choice might reasonably have gone either way, the fact is that in 1941 the Third Circuit in *Mesta,* followed a year later by the Second Circuit in *Halliwell,* adopted the view that a divorce settlement should be treated as a taxable transfer in satisfaction of a legal obligation. The Tax Court, which had been reversed in those cases, made clear its acquiescence at least by 1947 in its decision, reviewed by the full court, in *Hall* v. *Commissioner,* 9 T.C. 53. And in 1947 and 1950, the Second and Fourth Circuits applied the principle that a release of marital rights is a taxable exchange to property agreements made before and during marriage. *Farid-Es-Sultaneh* v. *Commissioner, supra* and *Commissioner* v. *Patino, supra.* That seemingly settled state of the law remained undisturbed until 1960, when the Sixth Circuit, in the *Marshman* case, rejected the *Mesta-Halliwell* principle and held the husband not taxable. Moreover, neither the Sixth Circuit in *Marshman* nor the Court of Claims in this case in terms rejected the view that a property settlement was in nature a taxable exchange, basing their decisions rather on the valuation ground discussed below.

There has thus been for many years substantial agreement among the lower courts on the principle that divorce settlements are to be treated as being taxable dispositions of property in exchange for a release from a legal obligation. And even if the decisions in *Marshman* and in this case be deemed a departure from that principle, though in terms based

on a different ground, the law was apparently taken as settled at least for the 19-year period intervening between the *Mesta* and *Marshman* decisions. The degree to which the parties to divorce settlements relied, during that period, upon the *Mesta-Halliwell* principle in negotiating their agreements can of course only be speculated. Even without demonstrable reliance, however, the principles that have become established in the lower courts ought to be accepted here in the absence of strong reasons for overturning them.

In short, even if as an original matter a divorce settlement might as readily be viewed as a "division" of property as an "exchange" in satisfaction of a legal obligation, the lower courts (including the Sixth Circuit and the Court of Claims, in principle) have unanimously adopted the latter view. The considerations pro and con being at best evenly balanced, that settled principle should not now be overturned.

C. A PROPERTY SETTLEMENT CANNOT QUALIFY AS A GIFT

Respondent alternatively argued in the Court of Claims that the transfer here should be treated as a "gift." That treatment would invoke the basis provision giving to property acquired "by gift" the same basis in the hands of the donee (for purposes of determining gain) as it had in the hands of the donor (§ 1015) and the settled principle (in part an implication drawn from the basis provision) that no gain is realized upon a gift of appreciated property.

Notwithstanding the seeming anomaly of treating as a "gift" a transfer made under legal compulsion—*i.e.*, to satisfy a legal obligation—we acknowledge that,

as an original matter, that might well have been the most satisfactory treatment of such marital transfers. The estate and gift tax provisions, generally applicable to transfers made without "an adequate and full consideration in money or money's worth" (*e.g.*, §§ 2036 (a), 2512(b)), have long been qualified by a general provision that a release of dower or "other marital rights" in a husband's property does not qualify as consideration (§ 2043(b)).[16] Thus the general rule is that transfers to a wife in exchange for her release of marital rights (*e.g.*, by an antenuptial agreement or agreement during coverture) are subject to the gift tax and, if certain interests are retained (*e.g.*, a life estate), to the estate tax. And similarly, of course, the wife's statutory share of a decedent's estate is includible in his estate for estate tax purposes (though now subject to the marital deduction) notwithstanding that she takes against the will and on the basis of a legal right given her by state law (§ 2034).

Those provisions reflect a basic Congressional judgment that marital rights and obligations—themselves voluntarily created and assumed in a transaction, the marriage, entered into for the most personal of reasons—ought not be treated as "commercial" obligations the satisfaction of which is removed from the reach of the transfer taxes (the gift and estate taxes) otherwise governing intra-family transfers. It is true that the gift tax and the income tax are not *in pari materia* and that a transaction need not be given the

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[16] The provision actually appears only in the estate tax provisions. The same limitation was read into the gift tax provisions, however, in *Merrill* v. *Fahs*, 324 U.S. 308.

same characterization for both purposes, but it might well have produced a more consistent structure as a whole to have treated all marital transfers—whether or not expressly in discharge of marital rights—as governed exclusively by the gift and estate taxes and not as income-taxable exchanges. Cf. Clark, J., dissenting in *Farid-Es-Sultaneh* v. *Commissioner,* 160 F. 2d 812, 815–816 (C.A. 2).[17]

The difficulty with that argument, however, is that the property settlement here was in fact not subject to the gift tax. While a transfer of property to a wife in exchange for a release of her marital rights is subject to the gift tax if made either before marriage, in an antenuptial agreement, or during coverture (*e.g.,* incident to an informal separation), it is not if made under a settlement agreement entered into within two years of a divorce. The origin of that exception is the decision in *Harris* v. *Commissioner,* 340 U.S. 106. There the Court, reasoning that the provision of the 1939 Code treating a release of marital rights as not adequate consideration was applicable only to transfers under agreements and not to those under a di-

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[17] The rationalization might be that a transfer in discharge of a legal obligation is a gift if the obligation itself was created by way of a gift transaction. The clearest example is a transfer to charity to satisfy a legally-enforceable pledge previously made. Another example might be the transfer to a son of property that was promised him should he refrain from smoking until he became of age (assuming the promise was an enforceable contract under state law). From those examples, it is a not impossible leap to conclude that a transfer to a wife to satisfy obligations voluntarily assumed, out of love and affection, at the time of marriage can reasonably be characterized as a "gift" for income tax purposes.

vorce *decree,* held that a transfer made pursuant to a court decree (though adopting a settlement agreement submitted by the parties) was not subject to the gift tax. There followed considerable litigation over the question whether a particular transfer provided for in an agreement was made pursuant to the agreement or pursuant to the decree approving it. To pretermit that area of controversy, Congress in the 1954 Code added the provision excepting from the gift tax all transfers pursuant to a property settlement agreement entered into within two years of a divorce (§ 2516).

Since that provision is applicable to the transfer here, it removes the very basis for an argument that the transfer should be treated as a "gift" for income tax purposes—namely, the desirability, if not necessity, of correlating the income and gift tax treatment of the transaction. Additionally, the premise of the *Harris* decision is that a transfer in exchange for a release of marital rights is not intrinsically of the nature of a "gift" and could be made so, if at all, only by an express provision directing that the release of such rights be ignored. Since no such provision can be found in the income tax statute, the transfer here can no more qualify as a "gift" under that statute than could the transfer in *Harris* qualify as a "gift" under the gift tax statute after the Court found that the explicit marital-rights provision there was inapplicable.[18]

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[18] Nor can the implications of *Harris* for income tax purposes be limited to transfers pursuant to a decree as distinguished from those pursuant to an agreement. That distinction was relevant in *Harris* only to determine the applicability of the express provision (now § 2043(b)) making a release of marital

It may be acknowledged that the *Mesta-Halliwell* principle that a transfer in exchange for a release of marital rights is a taxable exchange on which gain or loss is to be recognized produces what appears to be, at first sight, an anomalous consequence—namely, that in certain circumstances a single transfer may be deemed to be a taxable "sale or exchange" for income tax purposes and yet a "gift" for gift tax purposes, so that the husband is liable both for income taxes on the realized gain and for gift taxes on the gift. That would be true, in fact, of any such transfer pursuant to an agreement executed other than within two years of a divorce (*e.g.*, an antenuptial or separation agreement). Cf. *Farid-Es-Sultaneh, supra.* There are, however, two answers to the seeming anomaly. The first is that it is not necessarily incongruous that both taxes should be applicable, for the one is but a postponed tax on the economic gain accruing to the husband over the period during which the property appreciated in value, while the other is a tax on the transfer of the property. There is no more of a double tax than, say, when a gift is made of wages on which the income tax has been paid. The second answer is that a rule that transfers in exchange for a release of marital rights is not an income-taxable event would produce an equal anomaly—namely, that such transfers incident to a divorce would not be

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rights not adequate consideration. The holding that, if no such provision is applicable, such a transfer is not a gift is of much broader import and would apply to any transfer in exchange for a release of marital rights. See 340 U.S. at 112.

subject either to the income tax or to gift tax (*i.e.*, if the agreement is within two years of the divorce decree). Thus, even if a correlation of the income and gift tax consequences of such transfers be thought desirable or necessary—itself a debatable question—it can, under the present state of the law, be achieved only by Congress.

D. IF AN EXCHANGE OF PROPERTY FOR A RELEASE OF MARITAL RIGHTS IS OTHERWISE A TAXABLE EVENT, THE AMOUNT OF THE GAIN REALIZED CAN PROPERLY BE MEASURED BY THE VALUE OF THE PROPERTY TRANSFERRED

We have considered above what we conceive to be the dispositive issue in this case—namely, whether a property settlement incident to a divorce should be treated as a taxable "exchange" of property for a release of a legal obligation or as a nontaxable "division" of property. Assuming that the transaction is in kind a taxable "exchange", however, there remains the question of measurement of the gain upon which the Court of Claims based its decision. The court assumed that the release of the wife's marital rights was a "receipt" by the husband in exchange for the property and that there was a gain, of the kind intended to be taxed, to the extent that the value of the wife's released rights exceeded the husband's basis for the property transferred. The obstacle, in its view, was that the value of the wife's rights could not properly be measured by the value of the property accepted by her in exchange for them; that there was no other way to measure that value and hence to compute the gain;

and, accordingly, that the gain could not be taxed because it could not be computed.

We propose to show in this point that the stated ground of the Court of Claims' opinion is unsupportable and that, if the transaction is otherwise to be treated as a taxable exchange, the only feasible solution is to accept the value of the property transferred as the measure of the value of the wife's marital rights released in exchange.

1. In part, the opinion of the Court of Claims, and that of the Sixth Circuit in *Marshman* on which it relied, seems to imply that the value of what is received in an exchange can never be measured by the value of what is given—for example, even in the case of a transfer of property in settlement of a tort claim. To that extent, the court seems plainly wrong, for the valuation of property having no readily ascertainable market value in terms of the value of property exhanged for it is not uncommon. Thus, where there is no independent evidence of its value, the value of stock issued by a corporation in exchange for property is frequently determined by the value of the property. *E.g., Maine Steel, Inc.* v. *United States,* 174 F. Supp. 702, 714 (S.D. Me.); *Avco Mfg. Corp.* v. *Commissioner,* 27 T.C. 547, 556; *Livingston* v. *Commissioner,* 18 B.T.A. 1184, 1191. That method of valuation involves no more than the assumption that the parties judged the value of the property exchanged, in the arm's-length transaction, to be the equal of the property acquired, combined with the principle that their valuation should control in the absence of other evidence. *Kitrell* v.

United States, 79 F. 2d 259, 261 (C.A. 10). As explained by the Court of Claims itself in a prior case involving the issuance of stock in exchange for property (*Philadelphia Park Amusement Co.* v. *United States,* 126 F. Supp. 184, 189):

> The determination of whether the cost basis of the property received is its fair market value or the fair market value of the property given in exchange therefor * * * is generally not of great practical significance because the value of the two properties exchanged in an arms-length transaction are either equal in fact, or are presumed to be equal. * * *

Similarly, in a decision subsequent to its decision in *Marshman,* the Sixth Circuit, having held that an employers' transfer of appreciated property to its employees as additional compensation constituted a taxable event on which the gain should be recognized, had no difficulty in concluding that, lacking any better measure, the gain could properly be measured by reference to the value of the property transferred. *United States* v. *General Shoe Corp.,* 282 F. 2d 9, certiorari denied, 365 U.S. 843. The Second Circuit had reached the same conclusion, on substantially similar facts, in *International Freighting Corp.* v. *Commissioner,* 135 F. 2d 310 (C.A. 2).[19]

[19] We do not cite the *General Shoe* and *International Freighting* cases for their holdings that the transactions there involved were taxable events. Since we here rely on the release of a legal obligation, not present in those cases, as the receipt, the question whether there was a taxable event in this case is significantly different from that presented in those cases. We cite them only for the subordinate holding that, a taxable event once being found, the gain can properly be measured by the value of the property transferred.

2. Since both the Court of Claims and the Sixth Circuit have found no difficulty in other contexts with the use, if necessary, of a presumption that the values of exchanged properties are equal, it seems evident that the real holding, both here and in *Marshman,* was limited to the peculiar circumstances of marital property settlements. The basis for the decisions is thus to be found in the courts' common references to the "emotion, tension and practical necessities" involved in divorce negotiations, under which, in the Sixth Circuit's words (279 F. 2d at 32):

> * * * values are lost sight of, concessions are made, one does not expect or insist upon getting his money's worth for what he gives up. [Often what the husband gives] * * * is not given merely in exchange for a release of alimony and dower rights, but also includes, without being so labelled, such additional amount as the husband may be willing to pay in order to have the marriage terminated. A property settlement in a divorce proceeding is usually influenced and often dictated by numerous intangible, personal considerations * * *. The value of what is given up is no criterion of the fair market value of the "property" received.

There is, of course, much truth in those observations. To a degree probably uncommon in other kinds of negotiations, there may be many non-legal factors influencing the husband's willingness to agree to the wife's demands—not limited to what he may be prepared to pay to "buy" his wife's acquiescence in the divorce, but including such intangibles as feelings of guilt and societal or family pressures. And

to that extent, it is of course not mathematically precise to say that the final settlement reached necessarily reflects simply the parties' valuation of the legal rights of the wife. We also agree that it would be quite unworkable to make the result turn upon an analysis of the negotiations in each particular case to guess at what "factors" were in fact considered.

One may, however, recognize the infirmities in the premise without concluding it must be abandoned. However rough and ready the measure may be, it is the best available, and having concluded that the transaction produces the kind of gain that Congress wanted to be taxed, it is surely not an adequate effectuation of that purpose to balk at the imperfections in the tools available to measure it. Nor is this an area in which precise measurement of the values affects vital interests. Whatever the value is at which the husband is taxed will become the wife's basis in the property, and an error in that valuation will wash out—but for a shift in the incidence of the tax that can be taken into account in the negotiations—upon the wife's later sale of the property with a correspondingly reduced gain.

More basically, once it is determined that the transaction should be treated as taxable, there is simply no escaping the duty of making a valuation of some kind, if only by the use of a burden-of-proof rule, in order to determine the tax consequences to the taxpayers. Thus, while not styled as such, the net effect of the Court of Claims' holding that the taxpayer realized no taxable gain—and presumably is not to be allowed a deductible loss—is to treat the

"value" of what was received as precisely equal to the taxpayer's *basis* for the property transferred, a measure which most assuredly has nothing to commend it. It is surely preferable to utilize the best measure available than to resort to rules producing results having no justification at all. The one may be wrong, but the other is certain to be. Cf. *Helvering* v. *Safe Deposit Co.,* 316 U.S. 56, 66–67.

Additionally, once the question is seen solely as one of valuing the wife's marital rights, the court's decision cannot be squared with the burden-of-proof rules, for the burden was on the taxpayer to prove the assessment wrong, not upon the government to prove it right. *E.g., Commissioner* v. *Hansen,* 360 U.S. 446, 468. The result of the absence of any acceptable evidence of the value of what was received should, therefore, have been a judgment, not for the respondent, but for the government.

3. Finally, in terms of the consistency of the basis consequences to the wife, the ground adopted by the Court of Claims is the least justifiable of all the alternative grounds of decision available. Since the court views the settlement as a taxable exchange—*i.e.,* a "sale" of the property by the husband and a "purchase" of it by the wife, the "price" of which is the release of her marital rights—there seems no ground on which the husband's basis for the property would carry over to the wife, and she would acquire a new "cost" basis. But the court's holding that the "price" received by the husband (the release of the wife's marital rights) cannot be measured equally means that the "price" paid by the wife—*i.e.,* her

"cost" basis—cannot be measured. The only consequence that seems possible is that the wife would have to take a zero basis for the property. The result is that the wife, upon a subsequent sale of the property, would be taxable on the entire proceeds even if they were in fact less than the amount the husband originally paid for the property.

Here again it may be noted that the Court of Claims' reluctance to indulge the assumption that the wife's rights were worth what the husband agreed to pay, and she to accept, for them does not mean that the necessity for attaching some measure to them, at least in legal effect, disappears. It only operates to resolve the problem in the worst possible way, imposing upon the wife the same legal consequences that would follow from a determination that her rights were worth nothing.

In summary, while the ambiguity inherent in divorce negotiations and the possibility that the final settlement may reflect elements other than the parties' appraisal of the value of the wife's legal rights may be a relevant consideration in determining whether property settlements should be treated as taxable events at all, we do not believe it is a defensible solution to the problem to say that the transaction is in nature a taxable "exchange" but that the value of the receipts cannot be measured. Such an approach first makes the tax consequences dependent upon ascertaining that value and then, by refusing to make such a valuation, leaves them to be determined by a burden-of-proof rule that operates without regard to consistency of treatment between the two parties. If the

transaction is to be treated as a taxable event, there is, we submit, no choice but to adopt a workable rule for measuring the value of the wife's rights—and, thereby, the husband's gain and the wife's basis—and for that purpose no other solution is available but to accept the value of the property transferred as the measure.

To conclude this Point of the brief, we submit that property settlements incident to a divorce, while admittedly *sui generis* and not readily fitting into any established category, are most closely akin to, and ought to be treated as, taxable dispositions in satisfaction of independent liabilities, in which event the amount realized can properly be measured, in the absence of direct evidence of value, by the value of the property transferred. We acknowledge, however, that such transfers can tenably be assimilated to, though again they do not have all the characteristics of, "divisions" of property among those having rights to "shares" of it. Should the Court decide the case in favor of the respondent, we urge it to do so upon that ground rather than upon the stated ground of the Court of Claims' decision.

II

THE ATTORNEYS' FEES WHICH TAXPAYER'S WIFE INCURRED AND TAXPAYER PAID FOR TAX ADVICE IN CONNECTION WITH THE SEPARATION AND PROPERTY SETTLEMENT AGREEMENT INCIDENT TO THEIR DIVORCE ARE NOT DEDUCTIBLE BY TAXPAYER AS ORDINARY AND NECESSARY EXPENSES PAID "IN CONNECTION WITH THE DETERMINATION, COLLECTION, OR REFUND OF ANY TAX"

In accordance with the customary practice under Delaware law, taxpayer paid the attorneys' fees which both he and his wife incurred in connection with the separation and property settlement agreement they executed as an incident to their divorce. The fees paid included $5,000, paid in 1955, for advice as to the tax consequences of the proposed separation and property settlement agreement. Half of that amount was paid to the taxpayer-husband's attorney for advice given to him and the other half was paid to the wife's attorney for advice given to her. The taxpayer claimed a deduction for the entire $5,000 under § 212 (3) of the 1954 Code, which allows a deduction for the "ordinary and necessary expenses paid * * * in connection with the determination, collection, or refund of any tax." The Court of Claims allowed the deduction, under that section, of the $2,500 paid to the taxpayer's own attorney but denied the deduction for the $2,500 paid to the wife's attorney (R. 103-104).[20]

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[20] In addition to the $5,000 paid for tax advice and claimed to be deductible under § 212(3), the taxpayer had also paid fees for services rendered in the negotiation of the settlement agreement. For the latter he claimed a deduction under § 212(2), allowing a deduction for expenses incurred for the "manage-

Since the government, in its petition (No. 190), presented only the question dealt with in Point I of this brief (realization of gain), and did not seek review of the allowance of the deduction for the fees paid taxpayer's own attorney, the only issue of deductibility directly before the Court is the denial of the deduction claimed for the $2,500 paid to the wife's attorney for tax advice given to her (*i.e.*, the question presented by the taxpayer's cross-petition in No. 268). On that question, the decision below is, we believe, plainly correct. Fees incurred for advice as to the tax consequences of a proposed separation and property settlement agreement do not fall within the statutory allowance of expenses incurred in connection with the "determination, collection, or refund of any tax." Thus no deduction should have been allowed even for the tax-advice fees paid to the taxpayer's own attorney. In no event, moreover, can the taxpayer be entitled to a deduction for his wife's fees, for regardless of their nature as to the wife they were not "his" expenses.

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ment, conservation, or maintenance of property held for the production of income." That deduction was disallowed by the Court of Claims, however, and the taxpayer's petition did not seek review of that part of the decision. Thus the question in this case, though broadly related to the question in *United States* v. *Gilmore*, No. 255, and *United States* v. *Patrick*, No. 256, turns upon a different subsection (§ 212(3)) than the question in those cases (§ 212(2)) and presents a quite different issue of statutory interpretation.

A. ATTORNEYS' FEES FOR ADVICE AS TO THE TAX CONSEQUENCES OF PROPOSED TRANSACTIONS ARE NOT EXPENSES PAID IN CONNECTION WITH THE "DETERMINATION, COLLECTION, OR REFUND OF ANY TAX"

Both the wording of the statute and its legislative history make clear that the provisions of § 212(3) go no further than to allow the deduction of expenses incurred for the purpose of computing and contesting tax liability. Congress did not intend to allow a deduction for expenses incurred, as here, simply for advice as to the tax consequences of proposed future transactions.

The statute provides a deduction for ordinary and necessary expenses paid "in connection with the determination, collection, or refund of any tax." It cannot be contended that fees paid for advice as to the tax aspects of the various proposals under consideration in connection with the settlement agreement were paid in connection with either the "collection" or "refund" of any tax. It is equally clear that these fees were not paid for the "determination" of any tax. Determination of tax liability, no less than collection or suit for a refund, is something which can be done only *after* taxable or deductible transactions have occurred.

Doubtless in the present case each attorney advised his client how to shape his or her demands so as to minimize the resulting tax liability. But this was not a "determination * * * of any tax." Not only was there was no tax yet owing from the proposed transaction which could be determined, but the attorneys were not retained to determine the amount of any tax but only to plan a transaction so as to minimize the annual tax, whatever it might later turn out to be. Indeed, even if the attorneys had been retained to determine the effect

on each party's annual tax of the settlement transaction, they could not have done so, for such a determination is impossible without knowledge of the other transactions and events which would take place during the year and would affect the computation of tax liability.

Moreover, the Treasury Regulations on Income Tax (1954 Code), § 1.212-1(l), *infra*, p. 54, provide explicitly that the expense which is made deductible by § 212(3) is only for assistance in the computation or contesting of an accrued tax liability:

> Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be Federal, State, or municipal, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining *the extent of* his tax liability or in contesting his tax liability are deductible. [Italics supplied.]

The only activities which are recognized as being "in connection with the determination, collection, or refund of any tax" are those involved in the preparation of tax returns and in the determination and contesting of the extent of the taxpayer's liability. It is hardly necessary to repeat that the attorneys' functions in the present case were not and could not be a determination of *the extent of* the tax liability of either the taxpayer or his wife.

This reading of § 212(3) as applicable only to the cost of computation or contesting of an accrued tax lia-

bility is substantiated by the legislative history of the provision. In fact, the sole doubt as to the meaning of § 212(3) which survives a reading of the committee reports is as to whether only the expenses of contesting tax liability were to be deductible or whether, as the Treasury has construed the statute, expenses of computation were also deductible.

The Ways and Means Committee report (H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 29, A59) stated that—

> Existing law allows an individual to deduct expenses connected with earning income or managing and maintaining income-producing property. Under regulations costs incurred in connection with *contests* over certain tax liabilities, such as income and estate taxes, have been allowed, but these costs have been disallowed where the *contest* involved gift-tax liability. A new provision added by your committee allows a deduction for expenses connected with determination, collection, or refund of any tax liability. [Italics supplied.]
>
> *   *   *   *   *
>
> Paragraph (3) is new and is designed to permit the deduction by an individual of legal and other expenses paid or incurred in connection with a *contested* tax liability, whether the *contest* be Federal, State, or municipal taxes, or whether the tax be income estate, gift, property, and so forth. Any expenses incurred in *contesting* any liability collected as a tax or as a part of the tax will be deductible. [Italics supplied.]

The House report's emphatic repetition of the term "contest" was noted by the American Bar Association Section of Taxation, which pointed out at the Senate hearings on the new provision (1 Hearings before the Committee on Finance on the Internal Revenue Code of 1954, p. 487):

> While the language of section 212 by itself would appear not to present any particular problems, the language of the committee report on page A59 does raise a new problem with respect to the language of the bill. The language of the committee report appears to confine expenses in connection with tax matters to contested tax liabilities under paragraph (3) of section 212. Since a specific provision ordinarily controls a general provision, this might have the effect of limiting deductions with respect to all taxes, including even income taxes, to contested matters. It is believed that this result was not intended.
>
> This problem might be eliminated by adding the word "computation" before "determination" in section 212(3). In any event, the Senate Finance Committee report should clarify the point that deductions with respect to taxes are not hereafter to be confined to contested taxes.

Although the proposed clarification of the legislative history would have gone no further than the Treasury has now gone in recognizing the deductibility of services connected with the filing of a return, no action was taken on the suggestion of the American Bar Association. The language of the Senate Finance Committee report is substantially identical to that of the Ways

and Means Committee (S. Rep. No. 1622, 83d Cong., 2d Sess., p. 218):

> Paragraph (3) is new and is designed to permit the deduction by an individual of legal and other expenses paid or incurred in connection with a *contested* tax liability, whether the *contest* be Federal, State, or municipal taxes, or whether the tax be income, estate, gift, property, and so forth. Any expenses incurred in *contesting* any liability collected as a tax or as a part of the tax will be deductible. [Italics supplied.]

In sum, the plain meaning of § 212(3) and of the Treasury Regulation interpreting the section is more than confirmed by the legislative history of the provision. One could argue, as the American Bar Association did, that the committee reports suggest that even the expense of computation of an accrued tax liability does not fall within the words "determination * * * of any tax". But there is little room for doubt that at the very most § 212(3) was intended to include only the expenses of preparation of returns and of contesting tax liability.

B. TAXPAYER IS NOT IN ANY EVENT ENTITLED TO DEDUCT THE LEGAL FEES FOR TAX ADVICE WHICH HIS WIFE INCURRED

The attorneys' fees incurred by taxpayer's wife for tax advice and paid by him would not be deductible by taxpayer under § 212(3) even if it were less clear that Congress did not intend to allow a deduction under that section for fees for tax advice in relation to prospective transactions. True, taxpayer became obligated, by his own agreement, to pay the

wife's fees. But "[t]he mere fact that the expense was incurred under contractual obligation does not of course make it the equivalent of a rightful deduction * * *"; "[t]he origin and nature, and not the legal form, of the expense sought to be deducted determines" deductibility. *Interstate Transit Lines* v. *Commissioner,* 319 U.S. 590, 594. The fees paid to his wife's attorney were not for services rendered to the taxpayer, or even for services inuring indirectly to his benefit. As the court below stated (R. 104) in denying him a deduction for the wife's fees:

> In spite of the facts that Mr. Davis was legally liable for his wife's attorney's fees, the evidence conclusively shows that Mr. Morford worked exclusively for his client, Mrs. Davis, and considered the problems from the standpoint of his client alone. Certainly then it cannot be said that Mr. Morford's advice was directed to plaintiff's tax problems, and in order to qualify for a deduction, we think the attorney's fees must be directly and only connected with the taxpayer's estate. * * *

Thus, while tax advice was the subject matter of the wife's attorneys' fees, taxpayer's payment of these fees was not, as to him, an expense paid for tax advice. It was, instead, simply a part of his settlement with his wife—a liability which he assumed because he was advised that under Delaware practice it was customary for the husband to pay the wife's legal fees in connection with negotiations for a separation and property settlement agreement (R. 120). Cf. *Baer* v. *Commissioner,* 196 F. 2d 646,

649 (C.A. 8th); *Lewis* v. *Commissioner,* 253 F. 2d 821, 828 (C.A. 2d); *Richardson* v. *Commissioner,* 234 F. 2d 248, 250–252 (C.A. 4th). Section 212(3) does not allow husbands a deduction for payments made in discharging separation and property settlement obligations to a divorced wife.

CONCLUSION

The decision below should be reversed on the first issue (No. 190) and affirmed on the second issue (No. 268).

Respectfully submitted.

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JANUARY, 1962.

APPENDIX

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

*   *   *   *   *

(3) Gains derived from dealings in property;

*   *   *   *   *

(26 U.S.C. 1958 ed., Sec. 61.)

SEC. 63. TAXABLE INCOME DEFINED.

(a) *General Rule.*—Except as provided in subsection (b), for purposes of this subtitle the term "taxable income" means gross income, minus the deductions allowed by this chapter, other than the standard deduction allowed by part IV (sec. 141 and following).

*   *   *   *   *

(26 U.S.C. 1958 ed., Sec. 63.)

SEC. 212. EXPENSES FOR PRODUCTION OF INCOME.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

*   *   *   *   *

(3) in connection with the determination, collection, or refund of any tax.

(26 U.S.C. 1958 ed., Sec. 212.)

Sec. 1001. Determination of Amount of and Recognition of Gain or Loss.

(a) *Computation of gain or loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. In determining the acount realized—

(1) there shall not be taken into account any amount received as reimbursement for real property taxes which are treated under Section 164(d) as imposed on the purchaser, and

(2) there shall be taken into account amounts representing real property taxes which are treated under section 164(d) as imposed on the taxpayer if such taxes are to be paid by the purchaser.

(c) *Recognition of gain or loss.*—In the case of a sale or exchange of property, the extent to which the gain or loss determined under this section shall be recognized for purposes of this subtitle shall be determined under section 1002.

* * * * *

(26 U.S.C. 1958 ed., Sec. 1001.)

Sec. 1002. Recognition of Gain or Loss.

Except as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the gain or loss, determined under section 1001, shall be recognized.

(26 U.S.C. 1958 ed., Sec. 1002.)

8 Delaware Code Annotated, Title 12:

§ 901. *Widow's dower right*

The widow of any man, dying since February 16, 1816, who during their marriage was seized of an estate of inheritance in any lands or tenements within this State, shall have the third part of all the lands and tenements whereof her husband was seised at any time during the marriage, to hold to her as tenant in dower for and during the term of her natural life, free and discharged from all and every alienations, covenants, debts, liens and incumbrances, made, entered into, contracted, or created by the husband after the intermarriage, unless she shall have relinquished her right of dower therein by her own voluntary act, according to the existing laws of the State.

Title 13:

§ 1531. *Allowance or division of property upon divorce granted for aggression*

(a) When a divorce shall be decreed for the aggression of the husband, the complainant shall be restored to all her real estate, and allowed, out of her husband's real and personal estate, such share as the court thinks reasonable; but if the divorce be for the wife's aggression, the court may restore the whole or a part of her real estate, and also such share of her husband's personal property as seems reasonable.

(b) Any allowance or division of property under subsection (a) of this section, may be by a gross sum, or an annual allowance, or an assignment by metes and bounds. The court may appoint commissioners to execute any order in the premises, and may issue writs of possession, as in case of land sold on execution process.

1 Nevada Revised Statutes:

§ 125.150. *Alimony and adjudication of property rights; subsequent modification by court on stipulation of parties*

1. In granting a divorce, the court may award such alimony to the wife and shall make such disposition of the community property of the parties as shall appear just and equitable, having regard to the respective merits of the parties and to the condition in which they will be left by such divorce, and to the party through whom the property was acquired, and to the burdens, if any, imposed upon it, for the benefit of the children.

2. The court may also set apart such portion of the husband's property for the wife's support and the support of their children as shall be deemed just and equitable.

* * * * *

Treasury Regulation on Income Tax (1954 Code):

§ 1.212-1. *Nontrade or nonbusiness expenses.*—

* * * * *

(l) Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be Federal, State, or municipal, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining the extent of the tax liability or in contesting his tax liability are deductible.

* * * * *

§ 1.1001-1. *Computation of gain or loss*—(a) *General rule.* Except as otherwise provided in subtitle A of the Code, the gain or loss realized from the conversion of property into cash, or

from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained. The amount realized from a sale or other disposition of property is the sum of any money received plus the fair market value of any property (other than money) received. The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. The general method of computing such gain or loss is prescribed by section 1001, which contemplates that from the amount realized upon the sale or exchange there shall be withdrawn a sum sufficient to restore the adjusted basis prescribed by section 1011 and regulations thereunder (i.e., the cost or other basis adjusted for receipts, expenditures, losses, allowances, and other items chargeable against and applicable to such cost or other basis). The amount which remains after the adjusted basis has been restored to the taxpayer constitutes the realized gain. If the amount realized upon the sale or exchange is insufficient to restore to the taxpayer the adjusted basis of the property, a loss is sustained to the extent of the difference between such adjusted basis and the amount realized. The basis may be different depending upon whether gain or loss is being computed. For example, see section 1015(a) and the regulations thereunder.

*　　*　　*　　*　　*

§ 1.1002–1. *Sales or exchanges*—(a) *General rule.* The general rule with respect to gain or loss realized upon the sale or exchange of property as determined under section 1001 is that the entire amount of such gain or loss is recognized except in cases where specific provisions of subtitle A of the Internal Revenue Code of 1954 provide otherwise.

(b) *Strict construction of exceptions from general rule.* The exceptions from the general rule

requiring the recognition of all gains and losses, like other exceptions from a rule of taxation of general and uniform application, are strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Code only if the exchange is one which satisfies both (1) the specific description in the Code of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule. The exchange must be germane to, and a necessary incident of, the investment or enterprise in hand. The relationship of the exchange to the venture or enterprise is always material, and the surrounding facts and circumstances must be shown. As elsewhere, the taxpayer claiming the benefit of the exception must show himself within the exception.

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